In Credit

27 November 2023

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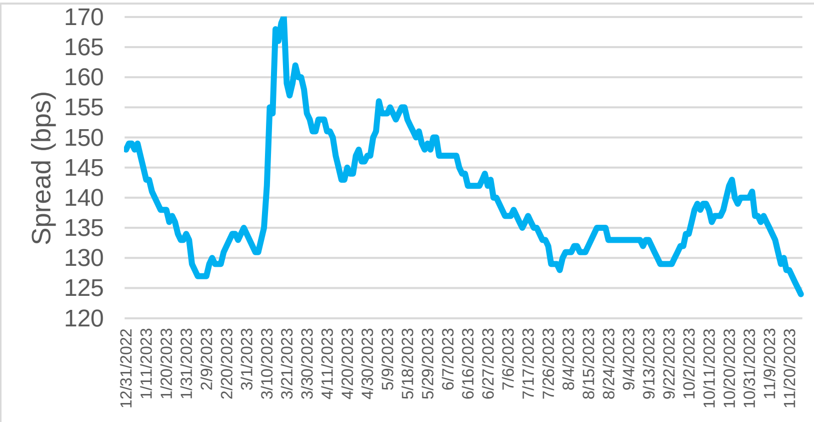
Risk rally returns.

Markets at a glance

	Price / Yield / Spread	Change 1 week	Index QTD return*	Index YTD return
US Treasury 10 year	4.48%	4 bps	1.3%	-0.5%
German Bund 10 year	2.63%	4 bps	1.6%	0.4%
UK Gilt 10 year	4.27%	17 bps	1.7%	-2.9%
Japan 10 year	0.78%	2 bps	0.0%	-0.5%
Global Investment Grade	124 bps	-4 bps	2.1%	3.2%
Euro Investment Grade	145 bps	-2 bps	1.6%	4.0%
US Investment Grade	114 bps	-6 bps	2.3%	2.8%
UK Investment Grade	123 bps	-1 bps	2.0%	3.2%
Asia Investment Grade	186 bps	-10 bps	1.7%	4.1%
Euro High Yield	443 bps	-18 bps	1.9%	8.3%
US High Yield	385 bps	-14 bps	2.2%	8.3%
Asia High Yield	721 bps	-37 bps	3.3%	-1.5%
EM Sovereign	342 bps	-15 bps	3.1%	4.2%
EM Local	6.6%	6 bps	4.2%	8.6%
EM Corporate	324 bps	-9 bps	1.6%	5.0%
Bloomberg Barclays US Munis	3.8%	-9 bps	3.8%	2.4%
Taxable Munis	5.5%	3 bps	1.7%	1.6%
Bloomberg Barclays US MBS	63 bps	5 bps	1.6%	-0.7%
Bloomberg Commodity Index	230.54	-0.4%	-2.5%	-5.8%
EUR	1.0950	0.2%	3.5%	2.2%
JPY	149.25	0.1%	-0.1%	-12.3%
GBP	1.2608	1.1%	3.3%	4.3%

Source: Bloomberg, ICE Indices, as of 24 November 2023. *QTD denotes returns from 30/09/2023.

Chart of the week – Global IG corporate bond spreads in 2023



Source ICE Indices, Bloomberg, Columbia Threadneedle Investments, as of 27 November 2023.

Macro / government bonds

In local currency terms, UK government bonds were 1.7% lower during the week, while US treasuries returned -0.3% and German bunds -0.1% respectively over the same period.

The big macro news in the UK was the Autumn Statement from UK chancellor, Jeremy Hunt, who made a £21bn giveaway, split over two years. It comprised the following elements: full expensing of business investment; a drop in national insurance for employees from 12% to 10%, while benefits would be increased in line with inflation and pensions in line with earnings. A more resilient UK economy, nominal wage growth, and the freezing of tax rates led to an increase in tax income for the chancellor. Despite the tax giveaway, the tax burden is still expected to rise to 38% of GDP by fiscal year 2028-29, according to the Office for Budget Responsibility. Public spending also remains frozen at current levels.

The tax giveaway raised an uncomfortable question, as to how monetary policy is likely to develop, at the same time as the UK government is modestly loosening fiscal policy. The OBR published its most recent economic and fiscal outlook in which it pointed to slower economic growth and higher more persistent inflation, much of which would be domestically fuelled. Its inflation forecast pushed out the point at which the 2% inflation target would be reached from H1,2024 to H1,2025. The reasons for this are the continuing presence of a positive output gap, which will take time to evaporate, and stronger than expected nominal wage growth. While the market digested news of the Autumn statement, screens for gilt valuations turned from green to red. An additional kicker to the long end of the gilt markets was the publication of the DMO's financing remit. Although the level of gilt sales barely changed for the remainder of the fiscal year, there was an increase of £1.6bn in long gilt sales, putting further upward pressure on yields at the long end. As a result of the Autumn statement, and its implication for monetary and fiscal policy, yields on 2-year gilts rose from 4.5% to 4.7%. Market participants reckoned that the Bank of England was likely to be more cautious in taking its foot off the monetary policy brake, as the UK government eases fiscal policy.

In the US, we had the publication of the US Federal Reserve minutes from the 31 October / 1 November meeting. There was no new information in the minutes. The Fed repeated its mantra that a period of below potential growth and some softening in labour market conditions were necessary conditions to meet its 2% inflation objective. All participants at the Fed meeting thought it appropriate for monetary policy to remain restrictive for an extended period. It was clear that the Fed was still in data gathering mode, which meant that data could still throw yields around either to the upside or the downside, until greater confidence emerges that the US economy has begun to slow meaningfully. Conditions were generally quiet otherwise in the US Treasury market ahead of the Thanksgiving holiday period.

The best performing core market was Germany. Manufacturing and Services PMI remains in contractionary territory. The German bond market, however, could not remain immune to the upward pressure on yields in the US market, and to a lesser extent, the UK.

Investment grade credit

It was a charcteristically quiet week for investment grade credit given the US Thanksgiving holiday.

This led to lower / low new issuance and a continuation of the trend tighter in credit spreads. By the end of the week, the Global Investment Grade index had a spread of 124bps, which is the tightest spread this year. These spreads were as wide as 170bps in March of 2023 according to data from ICE indices **(see chart of the week).**

Combined with lower government bond yields the total return for both the month and for the year are around 3%. Euro-denomnated spreads still trade wide of both shorter and longer term averages while the US dollar market is expensive to these markers.

High yield credit & leveraged loans

It was another positive week for European High Yield, returning 0.36% as spreads tightened in -18bps to 443bps though yields only fell -7bps to 7.64% due to higher underlying government bond yields. The market moved to compression on spreads as lower rated credits strongly outperformed higher rated credits with single Bs and CCCs returning almost 70bps on the week compared to around 20bps for BBs. The primary market was very quiet last week after the robust previous week. However, the year is not yet ready to close on new issues as there are a few opportunities in the wings, which are expected to come to the market within the next couple of weeks. November's total new issuance for EHY corporates is €5.6bn MTD bringing the YTD to €79.1bn, almost twice that issued for the same period in 2022. Net issuance remains very low at €2.6 bn YTD as most new bonds are refinancings.

In rating news, CERBA, French healthcare, was downgraded by S&P to B-, citing worse margins not being offset as synergies from recent acquisitions are taking longer to materialise.

The beleaguered TeleColumbus story is coming to an end with the announcement of a €300m equity injection and extension of the existing debt for five years to 2028.

Research houses have started to announce their economic forecasts for 2024. There is an interesting recession risk dichotomy with expectation of recession on a global basis, but with individual regions seeing at most some softness in growth but not calling a recession.

Asian credit

The Chinese authorities are taking additional steps to improve the lending environment and ease the financing difficulties for Chinese property developers. The PBOC, NAFR (National Administration of Financial Regulation) and CSRC (China Securities Regulatory Commission) have communicated to the domestic financial institutions to avoid asking early loan repayments from property developers which are operating normally.

The authorities have also asked the financial institutions to support the fundraising activities in bonds and equities in the property development sector. The Chinese regulators are drawing up a white list of 50 developers that are eligible for funding support. One noteworthy development is that this white list includes the POEs (privately owned enterprises) such as CIFI, Country Garden, Longfor, Seazen, Vanke and Sino-Ocean. Additionally, the authorities may allow financial institutions to provide unsecured short-term working capital funding to eligible developers for the first time. These recent developments are positive and could support the completion and delivery of under-construction property projects. That said, there is a lack of clarity about the willingness of financial institutions to extend additional financing to property development sector, especially to distressed developers.

In certain cities, there were additional measures to drive up home-buyer demand. The Shenzhen government announced cuts to the downpayment ratios on second homes to 40% (previously 70-80%), making it one of the first-tier cities to do so. The government is also easing the criteria for standard housing that enjoys preferential tax treatment.

Studio City has upsized the tender offer for its 6% senior notes (due 2025) from $75m to $100m. It has received valid tenders of around $317.5m and it expects the proration factor to be around 30.3%

The Indian Supreme Court has concluded the hearing related to SEBI's probe in Adani Group and reserved its orders for a later date. Importantly, the Supreme Court sees no reason to discredit SEBI because there was no material to doubt what SEBI has done and the Supreme Court does not have to treat what was set out in the Hindenburg short-seller report as a "true state of affairs". The Supreme Court defended SEBI's credibility in handling the probe on Adani and it also pushed back on the petition that two members of the Supreme Court appointed expert committee have conflicts of interest. Mr Tushar Metha (Solicitor General of India) said that SEBI has completed probing 22 of the 24 issues involved. For the two remaining issues, SEBI is awaiting inputs from foreign regulators before concluding its probe. SEBI also stated that it has agreed to strengthen its regulatory framework, based on the recommendations of a court-appointed panel.

Emerging markets

Emerging market hard currency bonds posted a positive return last week of +0.97% driven by 15bps of spread tightening while the return from US treasuries was negligible. We are currently seeing a compression theme play out in EM spreads with high yield assets outperforming investment grade. Lower volatility in US treasuries and good performance from credit spreads have fostered inflows for the asset class, +$193m over the week. YTD there have been around $30bn outflows, much improved from $90bn of outflows for 2022.

In central bank activity, Turkey hiked rates much more than expected, a 500bps rise to 40%. It's the sixth consecutive hike since June and the governor indicted that the pace going forwards would slow – inflation is currently 61%. South Africa held rates at a 14-year high of 8.25%. Hungary continued its monetary easing policy with a 75bps cut to 11.50%, in line with market expectation, while inflation printed just under 10% at the end of October.

Ratings news was quiet this week with Bahrain's outlook downgraded from positive to stable by S&P and Bolivia being downgraded to CCC+ by the same ratings agency.

Fixed Income Asset Allocation Views

27th November 2023

COLUMBIA THREADNEEDLE INVESTMENTS

Strategy and positioning (relative to risk free rate)		Views	Risks to our views
Overall Fixed Income Spread Risk	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Valuations are within historic ranges, tightening back in over the past month. Technicals seem stable; fundamentals show modest pockets of weakness, but no thematic deterioration. **The group stands neutral on credit risk overall, with no changes to underlying sector views.** ▪ The CTI Global Rates base case view is no cuts in 2023, with one more possible hike left in the hiking cycle. Focus remains on wages, labor market, financial conditions, and inflation expectations. ▪ Uncertainty remains elevated due to geopolitical tension, stricter lending, monetary policy tightening, persisting inflation, and weakening consumer profile.	▪ Upside risks: the Fed achieves a soft landing with no labour softening; consumer retains strength; end to Ukraine and Israel-Hamas wars. ▪ Downside risks: Fed is not done hiking and unemployment rises. Another banking crisis, this time from unrealised losses on securities and CRE, supply chain disruptions, inflation, volatility, commodity shocks re-emerge.
Duration (10-year) ('P' = Periphery)	¥ $ Short -2 -1 0 +1 +2 Long € P £	▪ Longer yields to be captured by long-run structural downtrends in real yields ▪ Inflation likely to normalize over medium term, although some areas will see persistent pricing pressures	▪ Inflationary dynamics become structurally persistent ▪ Labour supply shortage persists; wage pressure becomes broad and sustained ▪ Fiscal expansion requires wider term premium ▪ Long run trend in safe asset demand reverses
Currency ('E' = European Economic Area)	EM A$ Short -2 -1 0 +1 +2 Long ¥ € $ £	▪ Rising expectations around a soft landing and peak Central Bank rates have weakened the dollar ▪ EM disinflation to be more rapid than DM ▪ Drop in global rate volatility supports local flows.	▪ Central banks need to keep rates at terminal for much longer than market prices, to the detriment of risk and growth and to the benefit of the Dollar
Emerging Markets Local (rates (R) and currency (C))	R Under-weight -2 -1 0 +1 +2 Over-weight C	▪ Disinflation under threat but intact; EM central banks still in easing mode. ▪ Real yields remain high. ▪ Selected curves continue to hold attractive risk premium.	▪ Sustained high core rates thwart EM easing cycles. ▪ Energy persistence derails disinflation trend. ▪ US outperformance strengthens US dollar. ▪ Structurally higher global real rate environment subdues risk assets
Emerging Markets Sovereign Credit (USD denominated)	Under-weight -2 -1 0 +1 +2 Over-weight	▪ EMD spreads 15bps tighter than last month, benefiting from lower global rates. Technicals are slower, outflow and weak issuance. ▪ Conservatively positioned with most idiosyncratic opportunities in lower quality portion of index, focus on relval opportunities. ▪ Tailwinds: Stronger growth forecasts, Central bank easing, potential China stimulus, IMF program boost for distressed names. ▪ Headwinds: higher debt to GDP ratios, wider fiscal deficits, geopolitical and domestic political uncertainty, restructurings slow.	▪ China/US relations deteriorate. ▪ Issuance slows. ▪ Spill over from Russian invasion and Israel-Hamas war: local inflation (esp. food & commodity), slow global growth. ▪ Persisting COVID growth scars hurt economies & fiscal deficits.
Investment Grade Credit	Under-weight -2 -1 0 +1 +2 Over-weight	▪ US and EMEA spreads have tightened since last month. ▪ Fundamentals have proved resilient with decent earnings. Global portfolios prefer EUR IG over USD on relval basis. ▪ Fundamental concerns remain focused on commercial real estate, unrealised losses for banking sector, tight labor supply, and changing consumer behaviour.	▪ Lending standards continue tightening, even after Fed pauses hiking cycle. ▪ Rate environment remains volatile ▪ Mass layoffs spike, worsening consumer profile. ▪ Geopolitical conflicts worsen operating environment globally
High Yield Bonds and Bank Loans	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Spreads have tightened over the past month, while technical and high – quality HY fundamentals remain stable. October brought more rising stars, but also more defaults. Financial conditions continue to punish destressed names. ▪ Conservatively positioned, but open to attractive buying opportunities in short HY, BBs and higher quality loans. ▪ US HY defaults remain below historic averages, with greater default expectations for 2024. ▪ Bank loan market volatility has improved in the past month. Themes: neutral retail fund flows, slow primary deal flow, improving CLO issuance, increasing burden, credit concern in lower quality loans. Market performance mostly reflects idiosyncratic credit stories, not wider industry themes.	▪ Lending standards continue tightening, increasing the cost of funding. ▪ Default concerns are revised higher on greater demand destruction, margin pressure and macro risks ▪ Rally in distressed credits, leads to relative underperformance ▪ Volatility in the short end of the curve, eroding potential upside where we are positioned for carry. ▪ Loans see retail fund outflows once Fed starts lowering rates.
Agency MBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Mortgage index tightened in the past month; spreads still wide of historic medians. ▪ The group has reduced position sizing, but still overweight. Constructive view over longer time horizon. ▪ Supply is manageable as higher rates and fall seasonals kick in. ▪ Performance has been driven by the Fed's hiking cycle, with MBS widening into a bear steepener.	▪ Lending standards continue tightening even after Fed pauses hiking cycle. ▪ Prepayments normalise as rates rise without reducing mortgage servicing. ▪ Fed continues to shrink position. ▪ Market volatility erodes value from carrying.
Structured Credit Non-Agency MBS & CMBS	Under-weight -2 -1 0 +1 +2 Over-weight	▪ Positive outlook because of decent risk-adjusted valuations in select high quality Non-Agency RMBS, CLOs and ABS. ▪ RMBS: September saw spreads tighten. Home prices resilient, expect higher rates will slow growth. Delinquency, prepayment and foreclosure performance remains strong. We expect fundamentals to hold in as long as labor market strength remains. ▪ CMBS: The group is cautious, especially on office and multifamily, however non-office sectors perform as expected. Delinquencies increasing as maturities come due. Credit curve remains steep. ▪ CLOs: New issue steadily continues. Defaults remain low but CCC buckets continue to rise slowly with lower recoveries. ▪ ABS: Attractive relval in some senior positions. Higher quality borrowers remain stable, lower quality borrowers underperform. Fairly strong start to student loan repayment.	▪ Weakness in labour market ▪ Consumer fundamental position (especially lower income) weakens with inflation and Fed tightening. Consumer (retail/travel) behaviour fails to return to pre-covid levels ▪ Student loan repayments weaken consumer profile more than anticipated, affecting spreads on a secular level. ▪ Rising interest rates turn home prices negative, denting housing market strength. ▪ Cross sector contagion from CRE weakness.
Commodities	Under-weight -2 -1 0 +1 +2 Over-weight	▪ o/w Copper ▪ o/w Grains ▪ u/w Gold ▪ o/w Soybean Meal ▪ o/w Oil ▪ o/w Lead ▪ o/w Zinc	▪ Global Recession

Important information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Source for all data and information is Bloomberg as at 27.11.2023, unless otherwise stated.